No. 12498.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, as Receiver of the Estate of SALSBURY MOTORS, INC., Debtor,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION,

Appellee.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

This appeal is from an order denying a petition of the receiver to subordinate the claim of the Bank of America under a confirmed plan of arrangement. There was no hearing on the merits because the Referee and the District Judge were of the opinion that the bankruptcy court was without jurisdiction to entertain the petition. The receiver sought in his petition to defer any payment of dividends to the Bank on its claim against the debtor until all the other creditors of the debtor had been paid upon the ground that the Bank was guilty of such misconduct in dealing

with all the other creditors of the debtor as to require the bankruptcy court, under the doctrine of *Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 A. B. R. (N. S.) 279, to subordinate payment of dividends on the Bank's claim in order to prevent injustice and unfairness in the administration of the estate. The order appealed from would operate to deny the receiver the opportunity to prove the conduct of the Bank, which was described in the receiver's original petition and supplement thereto and the amended petition, so that the truth and significance of the facts alleged by the receiver can be ascertained. This is, of course, an extremely drastic result.

The reasons underlying a judgment or order which denies a party his day in court should be compelling. It is for this reason that the courts have universally applied the rule that in cases sought to be determined on their pleadings, every inference must be drawn in favor of the pleader *Abel v. Munro* (1940, 2nd Cir.), 110 F. 2d 647; *Avrick v. Rockmont Envelope Co.* (1946, 10th Cir.), 155 F. 2d 568; *Lane-Bryant, Inc. v. Maternity Lane* (1949, 9th Cir.), 163 F. 2d 559.

Although we contend that all of the points made by appellee in its brief herein are completely answered in appellant's opening brief, there are certain statements and contentions in appellee's brief which we feel should not be left unchallenged; hence, this reply brief.

ARGUMENT.

I.

The Bankruptcy Court Had Jurisdiction to Entertain the Receiver's Petition and to Grant the Relief Sought Therein.

(a) The Question of the Bank's Right to Receive Dividends on a Parity With Other Creditors Had Not Been Decided and Was Not Before This Court in the "Banker's Lien Appeal" and Therefore, the Bankruptcy Court Had Jurisdiction to Hear and Determine the Issues Raised by the Receiver's Petition.

The Bank's first contention is that the pendency of an appeal in this Court involving the same parties and arising out of the same Chapter XI proceedings somehow divested the bankruptcy court of jurisdiction to consider a petition to subordinate the payment of dividends on the Bank's claim.[1] The banker's lien appeal was from an order dated March 22, 1948, which constituted a ruling that a counterclaim asserted by the receiver against the Bank was not meritorious. On Page 7 of its brief, the Bank makes the following statement, with which we wholeheartedly agree:

> "The test would seem to be whether the order of March 22, 1948, allowing the Bank's claim decided the question of parity. If it did, the lower court properly held that it had no jurisdiction to entertain this petition."

Following this quotation, the Bank acknowledges that the grounds for subordination asserted by the receiver

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[1]The pending appeal was *Goggin v. Bank of America* (No. 12206), which was under submission with this Court on rehearing at the time appellant's opening brief was filed. On June 23, 1950, this Court filed its opinion affirming the lower court. The mandate has been stayed until September 23, 1950, pending the filing of a petition for writ of certiorari with the Supreme Court of the United States.

on this appeal were not raised at the time the banker's lien matter was litigated. The Bank adds sarcastically that undoubtedly the receiver would have asserted his subordination contention at that time, if it was meritorious. Thus, the Bank appears to be advocating a rule of law which would require pleadings to be construed against the pleader and would favor a ruling thereon disposing of the matter on the merits. Such a rule of law runs counter to the fundamental premise underlying the entire Anglo-American jurisprudence that controversies should be determined on their merits upon the basis of evidence adduced in open court.

We respectfully request this Court to consider the record in the banker's lien appeal to determine whether or not that proceeding either decided or in any way involved the subordination issues presented by this appeal. On Pages 18-20 of appellant's opening brief herein, we have set forth the basic differences between the banker's lien proceeding and this proceeding. Although the Bank attempts to make much of the fact that the banker's lien litigation was commenced by the receiver's filing a document entitled OBJECTIONS TO CLAIM OF THE BANK OF AMERICA . . . AND PRAYER FOR AFFIRMATIVE RELIEF [Tr. 48 in Case No. 12206], an examination of that document reveals that it was in no sense intended to defeat the claim of the Bank. The receiver there sought to defer a determination of the amount of the Bank's claim because the receiver alleged that the value of the security asserted by the Bank was not yet determined.

The second aspect of that proceeding was a counterclaim in which the receiver sought to have the Bank turn over to the receiver the commercial paper upon which the Bank had asserted a banker's lien. It is thus clear that at no time has the receiver ever contended that the Bank did not have a valid claim against the debtor.

On page 6 of its brief the Bank cites the decision of this Court in *Rothschild & Co. v. Marshall* (1931), 51 F.

2d 897 as holding "that the District Court and Referee lose jurisdiction over a *matter* when an appeal is perfected to this Court." Aside from the fact that the *Rothschild* case does not involve a bankruptcy proceeding and, therefore, cannot possibly represent any rule of law as to the jurisdiction of the bankruptcy court, we would have no quarrel with the statement in the Bank's brief. The question is, however, what is the "matter" involved in the banker's lien appeal. The record in that appeal will show beyond any doubt that the only "matter" there involved was the propriety of the Bank's exercise of a banker's lien. There was nothing in that proceeding which could conceivably be construed to include any of the issues in the "matter" involved on this appeal. The fundamental distinction between the allowance of a claim and the postponement of dividends on an allowed claim was recognized by the Supreme Court in *Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 A. B. R. (N. S.) 279 in stating:

> "Though disallowance of such claims will be ordered where they are fictitious or a sham, these cases do not turn on the existence or nonexistence of the debt. Rather they involve simply the question of order of payment."

Suffice it to say there must be a valid claim before there can be any question of subordination.

The effect of a pending appeal in a bankruptcy proceeding on the jurisdiction of the bankruptcy court would seem to be analogous to the doctrine of *res judicata*. In other words, if a final judgment in the banker's lien appeal would be *res judicata* on the subordination question, the Bank's position would be correct. The general rule is that in order to apply the principle of *res judicata,* it must be shown that the matter controverted in the second action was raised and litigated in the prior action. Thus, the allowance of a claim by a bankruptcy court is not *res*

judicata upon the issue of whether or not the creditor with the allowed claim has received a voidable preference from the bankrupt and the trustee may thereafter maintain an action to recover the preference.

Bloch v. Mill Factors Corp. (1941, 2nd Cir.), 119 F. 2d 536, 45 A. B. R. (N. S.) 748;

Stearns Salt & Lumber Co. v. Hammond (1914, 6th Cir.), 217 Fed. 559, 33 A. B. R. 484;

Buder v. Columbia Distilling Co. (1902, Mo.), 96 Mo. App. 558, 70 S. W. 508, 9 A. B. R. 331.

The Bank has seized upon the last sentence of the Referee's order in the banker's lien matter as making the parity question a part of that proceeding. [Tr. 179.] To be sure, the order provides that the claimant is entitled to dividends on its claim at the same rate paid to unsecured creditors, but read in context, it clearly appears that the language was used merely to instruct the receiver that no dividends were to be paid to the Bank until the security held by the Bank had been liquidated and the proceeds applied upon the claim. A proceeding in a bankruptcy matter is not like the ordinary litigation in which a judgment finally determines the controversy so that any appeal therefrom removes any further jurisdiction from the trial court. In a bankruptcy proceeding there may be many problems and disputes and an appeal from a ruling in connection with any single dispute does not in any way affect the jurisdiction of the bankruptcy court to proceed with the administration of the estate, even though it might require a determination of other disputes between the same parties who are involved in a pending appeal.

This fundamental distinction between bankruptcy proceedings and conventional civil litigation was recognized by Congress in defining the appellate jurisdiction of the Courts of Appeals under the Bankruptcy Act. The Courts of Appeals are given appellate jurisdiction from the bankruptcy courts "in proceedings in bankruptcy,

either interlocutory or final, and in controversies arising in proceedings in bankruptcy."[2] A "controversy" is similar to the ordinary type of non-bankruptcy litigation.

Despite the many confusing cases dealing with the difference between bankruptcy matters as proceedings or controversies,[3] it would seem to be beyond dispute that the banker's lien appeal was a proceeding. (*McDaniel National Bank v. Bridwell* (1934, 8th Cir.), 74 F. 2d 311, 26 A. B. R. (N. S.) 748.) An interlocutory order in a proceeding in bankruptcy is expressly made appealable under Sec. 24 of the Bankruptcy Act. The order involved in the banker's lien appeal was an interlocutory order because the amount of the claim allowed by the court was contingent upon the liquidation of the security. (*Robinson v. Edler* (1935, 9th Cir.), 78 F. 2d 817, 29 A. B. R. (N. S.) 502.)[4]

The taking of an appeal from an interlocutory order in a proceeding in bankruptcy does not, as it would with final orders, divest the bankruptcy court of jurisdiction to take further proceedings in the matter. (*Matter of Woodruff* (1941, 9th Cir.), 121 F. 2d 152, 46 A. B. R. (N. S.) 567; *Fernow v. Liberty Royalty Corp.* (1944, 10th Cir.), 146 F. 2d 396, 57 A. B. R. (N. S.) 659.)[5]

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[2]Section 24 of the Bankruptcy Act, 11 U. S. C., Section 47.

[3]See 2 Collier on Bankruptcy (14th Ed.), pages 721, 734, 758, 763.

[4]In the cited case this Court held that such an order was interlocutory. However, under the provisions of the Bankruptcy Act in effect at that time, such an order was not appealable without leave of the appellate court. The statute has since been amended so as to make an appeal from such an order a matter of right provided the amount involved exceeds $500.00; the amended statute was in effect and governed the banker's lien appeal.

[5]In the *Woodruff* case, this Court ruled that the bankruptcy court had jurisdiction to hear and determine the account and petition for compensation of the receiver and his attorneys, notwithstanding the fact that there was then pending in this Court an appeal from an earlier order of the bankruptcy court directing the receiver and his attorneys to petition for compensation and fees.

By reason of the obvious difference between the issues involved in the banker's lien appeal and this appeal, there is no merit to the Bank's assertion that the former appeal defeated the jurisdiction of the bankruptcy court to entertain the subordination proceedings; the bankruptcy court had jurisdiction to proceed with the administration and distribution of the fund deposited by the debtor under the confirmed plan of arrangement.

Regardless of which party ultimately prevails in the banker's lien litigation, the final ruling will merely serve to determine the correct amount of the Bank's claim. Thus, if the Bank prevails in the banker's lien matter, its claim will be for a lesser amount than it would be if the receiver prevails because if the Bank is ordered to return to the receiver the proceeds from the commercial paper on which it exercised a banker's lien, the Bank's claim will thereby be increased by an amount equal to the judgment in favor of the receiver. Upon a final ruling in the banker's lien appeal, there will still be a question as to the Bank's right to participate in dividends on its claim. That is the question involved in the instant appeal and which was in no way disposed of in the banker's lien appeal.

(b) The Plan of Arrangement and the Order of Confirmation Contained Sufficient Reservations of Jurisdiction to Empower the Bankruptcy Court to Hear and Determine the Issues Raised by the Receiver's Petitions; There Was Such Jurisdiction in the Bankruptcy Court Independently of the Plan and Order of Confirmation.

The provisions of the plan of arrangement, the creditors' consents thereto, and the order of confirmation showing the express reservations of jurisdiction in the bankruptcy court have been summarized at length in our opening brief. The Bank's contention that the order of confirmation takes precedence over the plan has been answered in our opening brief. (Pages 27-34.) The Bank fails to give

any significance to the provision of Section 368 of the Bankruptcy Act which makes the arrangement the source of the bankruptcy court's jurisdiction after confirmation of the plan. Moreover, the Bank has failed to mention the fact that the plan of arrangement was incorporated by reference into the order of confirmation. [Tr. 41.] The plan itself being a part of the order of confirmation, there can be no validity to the Bank's contention that there is a variance between the order and the plan.

On Page 11 of its brief, the Bank refers to the phrase "the classification of said claims" as used in the order of confirmation [Tr. 43] in defining the court's reserved jurisdiction. The same phrase is used in the plan itself in the paragraph defining the fourth group of creditors therein designated as Class D. [Tr. 46.] The Bank argues that the quoted phrase pertains only to placing a particular claim within one of the four classes called for by the plan. However, in context, the phrase appears in the plan as a part of the paragraph defining the group of creditors designated as Class D. It must, therefore, be assumed that its inclusion in that paragraph is wholly without significance in order to adopt the Bank's interpretation; this assumption is untenable.

Class D creditors are those creditors remaining after the three classes of priority creditors described in the plan as Classes A, B and C, and it is provided, with respect to Class D "that there shall next be paid to all other creditors of the above-named debtor, a prorata dividend in the same manner and with like effect as if an order of adjudication were entered herein, and the trustee in bankruptcy was paying a partial or final dividend, said payments to be made at such time and in such amounts as the court may from time to time, upon the petition of any party in interest, order . . . " [Tr. 46.] The phrase "classifica-

tion of said claims" immediately follows the foregoing provision in the plan as a part of the same sentence.

Thus, if a bankruptcy court, after an adjudication, would have jurisdiction to subordinate the claim of one unsecured creditor to the claims of other unsecured creditors, it could do so under the confirmed plan of arrangement in the instant case. The authorities showing that there is such jurisdiction in the bankruptcy court are legion and no reference is made to them in this reply brief for the reason that they are fully covered in our opening brief.

On Page 26 of its brief, the Bank again concedes that "a Bankruptcy Court has the general power and jurisdiction to subordinate the payment of dividends on claims as between creditors of the same class." The Bank, however, would limit the rule to straight bankruptcy proceedings where there has been an adjudication in bankruptcy. The contention seems to be that in Chapter XI proceedings, the court has only such jurisdiction as is expressly reserved in the order of confirmation. For the reasons set forth in our opening brief (Pages 34-38), the bankruptcy court in Chapter XI proceedings has inherent jurisdiction to subordinate the claim of one creditor to other creditors of the same class, regardless of the provisions of the plan and order of confirmation. It would appear, however, even under the Bank's view of the law, that there would be jurisdiction in the bankruptcy court in the instant case. A reading of the plan of arrangment, the consents of the creditors thereto, and the order of confirmation makes it abundantly clear that the draftsman of these documents took pains to provide that the administration of the estate after confirmation of the plan, was to be to like effect as if there had been an adjudication in bankruptcy and the receiver appointed as trustee in bankruptcy. Therefore, if in an ordinary bankruptcy proceeding, the bankruptcy court would have such jurisdiction and the trustee in bankruptcy would have authority to

bring such a petition, the bankruptcy court and the receiver in the instant case had jurisdiction and authority to subordinate the claim of the Bank to the claims of other creditors. The Bank, in support of its contention, has omitted to make any reference to or give any significance to these provisions of the arrangement, the consents thereto, and the order of confirmation.

In arguing that the receiver in this case is a sort of interloper in a controversy between creditors, the Bank has overlooked the numerous cases in which the courts have recognized the duty of the trustee in bankruptcy to bring before the bankruptcy court the facts and circumstances surrounding any claim so that dividends thereon will be subordinated to dividends paid on other claims where warranted after considering all the facts surrounding the claim. Some of the leading cases are mentioned on page 39 of our opening brief, but the Bank has failed to discuss those cases in its brief herein. In the instant case the receiver has alleged that all of the existing general unsecured creditors of the debtor were misled and prejudiced by the conduct of the Bank. Accordingly, if subordination of the Bank's claim is warranted, all of those creditors, would benefit. In any case where a receiver or a trustee succeeds in subordinating the claim of one creditor to the claims of other creditors he is taking sides in a matter which can be described as a controversy between creditors. However, he is the representative of the creditors generally and it is his duty to take whatever action is for their benefit. Even in objecting to a claim, a trustee in bankruptcy or a receiver is intervening in a matter which does not personally concern him but if he is successful in defeating the

claim, all of the other creditors will receive the benefit, unless, of course, any one of them has a claim which should be subordinated.

The Bank has cited *Prudence Realization v. Ferris,* 323 U. S. 650, 654, L. Ed. 528; *In re East Boston Coal Co.* (D. C. Pa.), 47 Fed. Supp. 593; and *In re Gordon* (D. C. S. D., N. Y. 1942) (Pages 15-21 of Appellee's Brief), in support of its position, but it has wholly ignored our discussion of those cases in appellant's opening brief in which we pointed out that they are all either Chapter X cases or they involve a situation where the bankruptcy court's jurisdiction is invoked after the entry of the final order discharging the receiver. The Bank merely mentions our contentions only to expressly ignore them. This, however, does not change the law. We pointed out in Footnote 18 on Page 31 of our opening brief that there is an express statutory distinction between Chapter X and Chapter XI insofar as the confirmation order may vary the plan of arrangement with respect to reserved jurisdiction. Moreover, there is another statutory distinction between the two chapters with respect to the court's right to modify a confirmed plan of arrangement. In Chapter X there is such authority in the bankruptcy court where there is none in Chapter XI (See Footnote 15, Page 29 of appellant's opening brief). Although the Bank takes the position that Chapter X and Chapter XI are similar, the distinctions above noted show that Chapter X cases are not controlling on the question involved in this Chapter XI proceeding.

Matter of Gordon (D. C. S. D., N. Y. 1942, 44 Fed. Supp. 581, cited at Pages 19-21 of the Bank's brief

herein) was a Chapter XI proceeding but the very portions of the opinion quoted by the Bank in its brief evidence the distinction between that case and the instant case. In the first place, the *Gordon* case clearly recognizes that jurisdiction may be retained by express reservation in a plan of arrangement. We think that was done in the instant case. Moreover, in the quotation from the *Gordon* case appearing on Page 19 of appellee's brief, the court recognized the reserved jurisdiction under Sections 369-370 of the Bankruptcy Act. Those sections would give the court jurisdiction to hear and determine a controversy such as that presented in the instant case. As has heretofore been demonstrated, the Bank's claim was in an unliquidated amount and was scheduled by the debtor. The claim cannot become liquidated until final disposition of the banker's lien appeal. Under Section 369(2) the court has jurisdiction over a dispute pertaining to such a claim.

On Page 21 of its brief, the Bank quotes a portion of the *Gordon* opinion in which the court speaks of "post-confirmation claims and post-confirmation conduct." The claim of the Bank, however, is a pre-confirmation claim; the conduct of the Bank set forth in the receiver's petitions was also prior to confirmation and, in fact, was prior to the commencement of the Chapter XI proceedings.

In summary on this point, it is respectfully submitted that the bankruptcy court in the instant case had jurisdiction, under the plan of arrangement, the order of confirmation and under its inherent jurisdiction, over the distribution of the funds in its possession which were to be administered as if there had been an adjudication in bankruptcy.

II.

The Petition and Supplement Thereto as Well as the Amended Petition Contained Allegations Sufficient to Warrant the Granting of the Relief Prayed For.

(a) The Receiver Had the Right, Power and Authority to Initiate the Current Proceedings.

A complete answer to the Bank's argument as set forth on Pages 22-28 of its brief herein, is contained on Pages 38-45 of appellant's opening brief. We do not desire to burden this Court with a repetition of the matters set forth in our opening brief other than to quote the succinct description of the trustee's duties as stated by Professor Collier:

> "The trustee's virtually exclusive right to object on behalf of creditors has just been discussed in connection with the rights of the bankrupt and the creditors. It is the corollary of his statutory duty under §47a(8) to 'examine all proofs of claim and object to the allowance of such claims as may be improper.' A trustee in bankruptcy has not only the right, but the duty to object to any claim not entitled to proof or allowance. This duty *virtute offici* may be enforced by the court upon petition of a creditor or the bankrupt. It also extends to the case in which a creditor has an allowable claim against the bankrupt, but a claim that should not be treated on a footing of equality with the claims of creditors who have been wronged by the claimant. It is then the trustee's duty to object and to see to it that the claim be subordinated to those of the wronged creditor or creditors."[6]

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[6]3 Collier on Bankruptcy (14th Ed.), pages 226-227.

The foregoing quotation also demonstrates the distinction between the allowance of a claim and the subordination of an allowed claim.

The bankrupt has again cited to this Court the case of *Schroeder v. Brack* (1935, 7th Cir.), 78 F. 2d 530, 29 A. B. R. (N. S.) 444 (this is the same case referred to as *In re Railroad Supply Co.* on page 43 of our opening brief). As pointed out in our opening brief, however, this Court in *Bank of America v. Erickson* (1941), 117 F. 2d 796, 45 A. B. R. (N. S.) 503, ruled that the *Railroad Supply* case only concerned a dispute between two creditors of a bankrupt which was of no concern to other creditors or to the estate. It would appear that the Bank is attempting to come within the *Railroad Supply* rule upon the basis of its assertion that the instant case involves conduct of the Bank which affected only some of the creditors of the debtor. This assertion is, however, contrary to the pleadings which are deemed admitted for the purpose of this appeal. The receiver alleged in the supplement to his original petition:

> "That the current unpaid trade creditors in the within reorganization proceedings extended credit to the debtor substantially in reliance upon the position taken by the Bank of America and the misinformation circulated by it in connection with the financial condition of the debtor and the purported financial support thereof by Northrop Aircraft, Inc.; that the Bank of America well knew that the said creditors would so rely upon the facts as alleged hereinabove in extending credit to the debtor herein." [Tr. 65.][7]

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[7]The allegations in the amended petition were even more specific on this score:

> "That in extending credit to the debtor, all of the persons who are the general unsecured and unpaid trade creditors of the debtor herein and whose claims have been allowed by this Court relied upon and were misled by the conduct of and the credit information given by the Bank of America as hereinabove particularly described." [Tr. 100.]

Since the pleadings must be construed in favor of the pleader, it would seem clear that the aforementioned allegation sufficiently establishes that the conduct of the Bank affected all of the unpaid trade creditors in the within proceedings.

We do not mean to indicate by the foregoing that we concur in the Bank's statement of the law that in order for a trustee in bankruptcy to subordinate the claim of one creditor, he must show that the conduct of that creditor adversely affected all of the remaining creditors. The Supreme Court has indicated that such is not the law and that a trustee may properly subordinate the claim of one creditor to the claim of only a portion of the remaining creditors. (*American Surety Co. v. Sampsell* (1946), 327 U. S. 269, 90 L. Ed. 663, 66 S. Ct. 571.) In that case the Supreme Court of the United States affirmed a judgment of this Court holding that a trustee in bankruptcy had authority and the bankruptcy court had jurisdiction to subordinate the claim of one creditor to the claims of certain creditors.

Thus, the Bank's premise is not in accordance with the settled law. However, the pleadings in the instant case are to the effect that *all* of the creditors were misled by the Bank's conduct. In view of the facts stated by the receiver in his petitions, he would have been derelict in his duty had he not brought them to the attention of the bankruptcy court.

(b) The Allegations in the Petition and Supplement Thereto as Well as the Amended Petition Are Sufficient to Warrant Subordination of the Bank's Claim to Those of All Creditors.

The Bank's assertions on pages 28 and 29 of its brief that the receiver was never refused permission to file his amended petition is not only without support in the record but is in direct conflict therewith. At the conclusion of the original hearing when the Referee indicated his ruling

would be adverse to the receiver, counsel for the receiver, in open court, sought leave to amend the petition and the Referee indicated that leave would be granted; however, after a colloquy with counsel for the Bank, who objected to the granting of leave to amend, the Referee stated that his ruling would be limited to the lack of jurisdiction objection made by the Bank. [Tr. 159-160.] Therefore, no amendment would be appropriate under such a ruling. Thereafter, there was a hearing upon the receiver's motion to reconsider that ruling and when the Referee denied the motion, counsel for the receiver again sought leave to file an amended petition and again counsel for the Bank objected; whereupon the Referee ruled "I will deny your right to file the amended petition at this time." [Tr. 155-157.] The Bank then submitted a form of order to which the receiver filed objections. [Tr. 86-91.] In his objections to the form of order the receiver formally sought leave to file an amended petition in the event the Referee was inclined to rule that the allegations in the original petition and supplement thereto did not sufficiently state a cause of action [Tr. 89-91], and a copy of the proposed amended petition was attached to the objections. The objections to the form of order came on for hearing and at the conclusion thereof, the Referee overruled the receiver's objections and counsel for the receiver requested leave to file the amended petition. At this point the Referee permitted the receiver to "file" the amended petition and stated "but I am not granting you permission to file it with the thought that I will pay any attention to it. . . . You can file any document you want, but it must be understood it was filed after I made my ruling." [Tr. 165-166.]

The record, therefore, shows a consistent and continuous attempt on the part of the receiver to file an amended petition with a persistent refusal on the part of the Referee to permit the amendment. Although eventually the Referee permitted the receiver to file the amended

petition, he made it clear that he would not "pay any attention to it." [Tr. 165.]

This brief summary of the record demonstrates the inaccuracy of the statements contained at pages 28 and 29 of the Bank's brief. Despite this record, the Bank draws an inference that counsel for the receiver was extremely reluctant to file the amended petition because the amendment was proposed only after the Referee had announced his ruling adverse to the receiver. Surely counsel for the Bank is aware that leave to amend a pleading is generally sought only after a court has ruled that the original pleading is defective.

The Bank closes its argument with a reference to two relatively recent Supreme Court decisions, *Comstock v. Institutional Investors* (1947), 335 U. S. 211, 92 L. Ed. 1911, 1923, and *Manufacturers Trust Co. v. Becker* (1949), 338 U. S. 304, 94 L. Ed. 99, 70 S. Ct. 127. We have already referred to the *Manufacturers Trust Co.* case in our opening brief (page 37). The *Comstock* case constitutes a compelling authority in support of the position of appellant herein. There the Supreme Court affirmed the judgment of the Court of Appeals for the 8th Circuit which, in turn, had affirmed the judgment of the trial court refusing to subordinate the claim of a parent corporation asserted against its subsidiary in a railroad reorganization proceeding. A reading of the opinion shows that the controversy was fully tried on all of the facts, at the conclusion of which the trial court made findings that the parent corporation had acted in good faith at all times, that the indebtedness upon which its claim against its subsidiary was based was a valid indebtedness, and that the proceeds of the loans had been used for the benefit of its subsidiary and its creditors. By reason of these findings and their affirmance by the Court of Appeals, the Supreme Court affirmed the judgment, stating: "A seasoned and wise rule of this Court makes concurrent findings of two courts below final here in the absence of exceptional error."

(Citing numerous cases.) There was a four-man dissent because the dissenting justices felt that there was an exceptional error in the record. In any event, that case illustrates the necessity for the bankruptcy court's holding a hearing upon the pleadings which are alleged to require the subordination of one claim to the claims of other creditors. Thus far, the receiver in the instant case has been denied that right. If the receiver is given the opportunity to go to trial upon the basis of his pleadings, he cannot and surely will not complain if he is not able to prove by appropriate evidence that which he has alleged.

The authorities discussed in our opening brief establish that a court of bankruptcy, upon a proper showing, has jurisdiction to subordinate the payment of the claims of one creditor to those of the other creditors of the same class where such subordination will further the ends of justice and equity. Upon proof of the allegations of the receiver's petition and supplement thereto or the amended petition the claim of the Bank should be subordinated to the claims of other creditors. Thus, upon the pleadings, the receiver is entitled to the relief requested.

Conclusion.

We respectfully contend that the record in this case requires a reversal of the rulings below. The banker's lien appeal was wholly foreign to the matters involved in this appeal and its pendency in no way affected the power of the bankruptcy court to determine the order of payment of dividends on claims. Under the plan of arrangement, the order of confirmation thereof and the inherent jurisdiction of the bankruptcy court to administer the fund in its possession, there was clearly jurisdiction to hear and

determine the receiver's petitions. Furthermore, a perusal of these documents shows that it was the intent of all of the parties concerned to carry on the Chapter XI proceedings as if there had been an adjudication in bankruptcy. The Bank has conceded that had there been such an adjudication, the court would have had jurisdiction. This constitutes a concession that the rulings below were erroneous because by the express provisions of the plan and order of confirmation, the jurisdiction of the bankruptcy court and the authority of the receiver were defined to be co-extensive with that which would have prevailed had there been an adjudication in bankruptcy.

The pleadings, which are the basis of this appeal, are deemed admitted and they entitle the receiver to the relief requested. The receiver, for the benefit of the unsecured creditors of the debtor who were misled by the wrongful conduct of the Bank, is merely asking for the opportunity to prove the allegations of his petitions. Only in this manner can the bankruptcy court sift the circumstances surrounding the Bank's claim to see that the distribution of the consideration deposited by the debtor under the confirmed plan of arrangement is administered pursuant to law, equity and justice.

It is, therefore urged that the orders appealed from be reversed and the matter remanded to the bankruptcy court with directions to proceed upon the allegations of the receiver's amended petition.

Respectfully submitted,

GENDEL & RASKOFF,
By H. MILES RASKOFF,
Attorneys for Appellant.